THE REPUBLICAN STUDY COMMITTEE
BUDGET & SPENDING TASK FORCE
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Congressman Scott Garrett (R-NJ), Chairman **December 7, 2011**

House Budget Committee Proposes to Reform Budget Process

This morning, House Budget Committee Republicans proposed a series of reforms to the budget process. The reforms consist of the following:

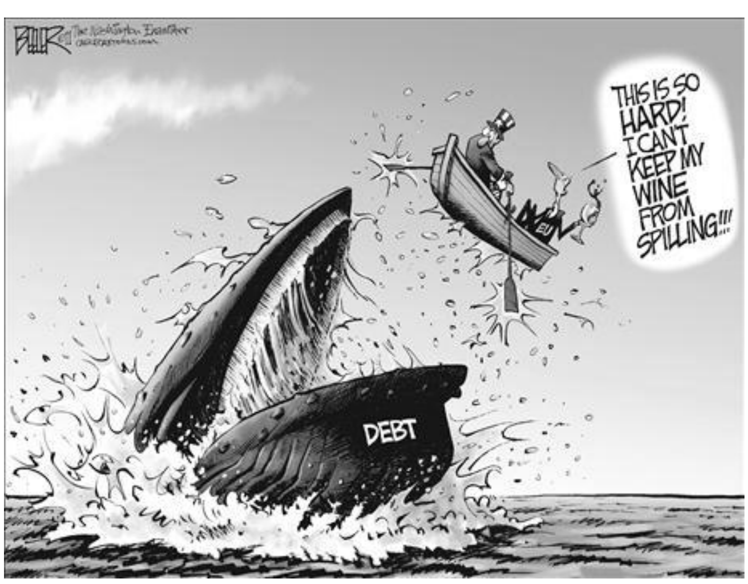
> **Quote of the Week:**
>
> *"A government bureau is the nearest thing to eternal life we'll ever see on this earth."*
>
> **-Ronald Reagan, 1964**

- **The Legal Binding Budget Act:** Turns the federal budget into a legally binding document. ***Sponsor:*** *Rep. Diane Black.*
- **The Spending Control Act:** Places caps on federal spending and deficits backed up by sequestration. ***Sponsor:*** *Rep. John Campbell.*
- **The Expedited Line-Item Veto and Rescissions Act:** Requires Congress to consider, in an expedited timeline, requests by the President to cut discretionary spending. ***Sponsors:*** *Chairman Paul Ryan and Rep. Chris Van Hollen.*
- **The Biennial Budgeting and Enhanced Oversight Act:** Moves to a biennial budgeting cycle, with the second year dedicated to authorization legislation and oversight. ***Sponsor:*** *Rep. Reid Ribble.*
- **The Baseline Reform Act:** Requires zero baseline budgeting by eliminating automatic inflation increases in discretionary spending projections by CBO. Instead a program would be compared to previous year spending. ***Sponsor:*** *Rep. Rob Woodall.*
- **Government Shutdown Protection Act:** Provides a backup continuing resolution (at a lower spending level) if Congress fails to enact an appropriations bill. ***Sponsor:*** *Rep. James Lankford.*
- **The Review Every Dollar Act:** Requires reauthorization of all federal programs, and sunset reviews, to decide whether programs perform an appropriate role and are operating effectively. ***Sponsor:*** *Rep. Jason Chaffetz.*
- **The BOLT Act:** Among other things, requires federal spending to be limited to 20% of GDP. ***Sponsor:*** *Rep. Mick Mulvaney.*
- **The Budget and Accounting Transparency Act:** Provides a more accurate look at the federal budget by reforming the Credit Reform Act to incorporate Fair Value accounting principles, bringing the GSEs and U.S. Postal Service on-budget, and requiring all federal agencies to make publicly available budgetary justification materials. ***Sponsor:*** *Rep. Scott Garrett.*
- **The Pro-Growth Budgeting Act:** Requires CBO to project the economic impact of legislation. ***Sponsor:*** *Rep. Tom Price.*

Dueling Tax/Spending Extenders Plans

House: According to media reports, the House plan, to be considered next week, will extend the payroll tax by one year, extend the "doc fix" for two years, and extend the "emergency" Unemployment Benefits program extension by one year. According to reports, these tax cuts/spending increases would be paid for with spending cuts. These might include a freeze on federal pay through 2015, higher premiums for higher-income Medicare recipients, and limiting other federal benefits for millionaires. Finally, the bill may expedite approval of the Keystone XL pipeline and block environmental regulations on boilers.

Senate: Senators McCaskill (D-MO) and Collins (R-ME) have unveiled a plan to extend the payroll tax cut by one year and to increase the top marginal income tax rate by an additional 2 percentage points for ten years.



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THE WALL STREET JOURNAL.

Basel's Sovereign-Debt Bubble

Wall Street Journal Editorial

Standard & Poor's Monday night put nearly every country in the euro zone on notice for a possible credit downgrade. The glorious exceptions were Cyprus, which was already on CreditWatch, and Greece, which is already rated junk. European officials denounced the announcement as counterproductive and somehow politically motivated, but the rating agencies are merely catching up to the reality that sovereign debt isn't a risk-free asset.

This same realization may even be dawning at last on the international banking regulators in Basel, Switzerland. Business Week reports that the authors of the Basel standards, which set capital and liquidity requirements for large international banks, are reconsidering rules that all but require banks to hold large amounts of sovereign debt

Unfortunately, the rules under review concern only the new liquidity buffers that banks will need to hold under the forthcoming Basel III standards. Under this new requirement, banks are supposed to have a 30-day supply of funds available in case lending markets seize up as they did in the fall of 2008, and 60% of that supply is supposed to be in high-quality, highly liquid assets, such as, believe it or not, government bonds.

As Peter Wallison has written on these pages, the Basel rules have been pushing banks into government bonds for years on the assumption that they represent a risk-free asset. Under Basel's risk-weightings, government debt of your home country is assigned a zero risk under both the old rules and the new.

The rationale is that a government can always tax more or print more money to pay off its debts, at least nominally. So a country that issues debt in its own currency should in theory never be forced into actual default, even if it has to resort to inflationary money printing to avoid it.

On this, the Basel gnomes have a point, even if it's taken everyone too long to realize that this option wasn't open to the likes of Greece and Italy. But even when correctly applied, those rules create systemic risk by nudging large banks toward holding similar assets. This reduces diversity in the system, increasing the odds that if one bank is in trouble, all or most of them will also be in trouble.

A normal market has a balance of buyers and sellers, longs and shorts, bulls and bears. But risk-weightings put a thumb on the scale. Recall that the Basel rules also assigned a very low risk-weighting to triple-A-rated mortgage-backed securities, which helps explain why sleepy banks in Dusseldorf loaded up on the stuff during the housing bubble and lost billions during the panic.

And now here we are doing it again with sovereign debt. In a paper commissioned by the European Parliament in 2010, former Commerzbank Chairman Achim Kassow notes dryly that "The regulatory incentive which results from the 0% risk weight is apparent: banks in Member States are effectively encouraged to place their most liquid assets into the worst possible government debt, maximizing the yield with a regulatory capital requirement of zero."

It's encouraging that the Basel rule makers are considering even a limited climb-down from pushing banks into government bonds, but the whole policy needs revision.